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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 630

THE EQUITY CORPORATION,
Petitioner,

v.

BARTHOLOMEW A. BRICKLEY, Trustee, and the SECURITIES & EXCHANGE COMMISSION, ET AL.,
Respondents.

PETITION OF THE EQUITY CORPORATION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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(3) After the entry of a District Court order made upon the application of the Commission vested that Court with exclusive jurisdiction of the company for the sole purpose of enforcing the dissolution order; and

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Respondents.

PETITION OF THE EQUITY CORPORATION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

The Equity Corporation ("Equity"), prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit, made and entered October 26, 1956 (R 905),[1] in the appeals entitled "The Equity Corporation, Appellant, against Bartholomew A. Brickley, Trustee, et al., Appellees" (No. 5127) and "Central-Illinois Securities Corporation, et al., Appellants, against Bartholomew A. Brickley, Trustee, et al., Appellees" (No. 5128), affirming an order of the United States District Court for the District of Massachusetts ("District Court") entered April 23, 1956 (R 891) (Ford, J.), approving the order of the Securities and Exchange Commission ("Commission"), dated January 13, 1956 (R 880). This Commission order modified its prior order of July 21, 1942 under Section 11(b) of the Public Utility Holding Company Act ("Act") directing International Hydro-Electric System ("IHES") to liquidate and dissolve and permitted IHES to continue as an investment

1. "R" references are to Consolidated Joint Record Appendix.

company under a plan filed pursuant to Section 11(d) of the Act. This plan did not grant a right of appraisal or withdrawal to objecting stockholders. The Commission's order disapproved the proposals of petitioner, Equity, the plan of Central-Illinois Securities Corporation ("Central-Illinois") and Christian A. Johnson ("Johnson"), and the plan of the Class A Stockholders Protective Committee, all of which proposals and plans provided for a right of withdrawal or appraisal to dissenting stockholders.[2]

The District Court granted a stay pending appeal to the Court of Appeals without requiring a supersedeas bond (R 903). The Court of Appeals granted a stay of its mandate pending disposition of this petition for certiorari without any supersedeas bond.

Opinions Below

The opinion of the Court of Appeals (Appendix A) is not yet reported. The District Court wrote no opinion. The findings and opinion (HCAR 13044)[3] (R 847) and the order of the Commission (HCAR 13083) (R 876) are not yet reported.

Jurisdiction

The judgment of the Court of Appeals was dated and entered on October 26, 1956. The jurisdiction of this Court was invoked under 28 USC Secs. 346, 347, made

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2. Equity presently owns approximately 35,000 Class A shares of IHES with a market value of about $1,250,000. As will be shown later, Equity, Johnson and Central-Illinois and their affiliated interests in a proxy contest for the election of the Interim Board received about 1,000 cumulative votes less than the majority of the Interim Board. All these affiliated interests are unequivocally opposed to the plan approved by the Commission by reason of its failure to provide a right of withdrawal. Johnson and Central-Illinois are also petitioning for a writ of certiorari on a companion appeal from the order of the Court of Appeals on a consolidated record appendix.

3. "HCAR" references are to releases issued by Commission under the Act; such references, without company identification relate to IHES.

applicable by Section 24(a) of the Public Utility Holding Company Act of 1935, Title I, 49 Stat. 803, 15 USC Sec. 79 *et seq.*

Statements of Questions Involved

1. Did the Commission have jurisdiction to modify the Commission's prior order under the Public Utility Holding Company Act directing the dissolution of a holding company and to continue the existence of such company as an investment company.

(A) After such dissolution had been affirmed by a Court of Appeals;

(B) After a Commission order denying an application to modify such dissolution order and to permit the continued existence of such company had been affirmed by a Court of Appeals;

(C) After the entry a District Court order made upon the Commission's application, vested that Court with exclusive jurisdiction of the company for the sole purpose of enforcing the dissolution order; and

(D) No application had been made to any of these courts to modify their respective orders directing dissolution or for leave to institute the instant proceeding to modify such dissolution orders as affirmed and to continue the existence of this company?

2. Were these prior court orders directing dissolution *res adjudicata* upon the instant issues of dissolution and the continuance of the company: or in any event did these prior orders of dissolution as affirmed which effectuate the purposes and provisions of Section 11(b) of the Act fairly and equitably simply by a distribution of the company's fungible assets equitably estop the Commission from modifying such dissolution orders?

3. Assuming that the Commission had jurisdiction and was not concluded or estopped by the prior court

orders, did the plan approved satisfy the Standards of the Act that the plan be fair and equitable and was the Commission's approval appropriate and necessary, in the public interest and in the interest of investors in view of the facts:

(A) no right of appraisal, redemption or withdrawal of their pro rata share of the fungible assets was afforded to dissenting stockholders as a condition to the transmutation of the holding company in dissolution to an investment company;

(B) such approval sanctioned acts and conditions which would have violated the provisions, intent and spirit of the Investment Company Act had IHES been a registered investment company; and

(C) such approval sanctioned and approved acts and conditions which are violative of principles of law defining corporate fiduciary duties.

Statutes Involved

The statutes involved are the Public Utility Holding Company Act of 1935, Title I, 49 Stat. 803 (1935), 15 U.S.C. 79 and particularly Sections 11(b), 11(d) and 24(a) and the Investment Company Act of 1940, 15 U.S.C. 80, particularly Section 36 (Appendix B).

Reasons Relied on for the Allowance of the Writ

The reasons relied on by petitioner for the allowance of the writ of certiorari by this Court are:

(1) Important issues of administrative law and the spheres of authority of the courts and administrative agencies, particularly the Securities and Exchange Commission are involved, mostly issues of first impression, including:

(A) whether an administrative agency has jurisdicton to modify an order after such order and findings of facts and conclusions of law upon which it is based are affirmed by a Court of Appeals

without a prior application to the Court for permission to institute proceedings for such modification;

(B) whether an order of a Court of Appeals affirming an order of an administrative agency and the findings of facts and conclusions of law upon which such order is based has any adjudicative or conclusory effect in any subsequent proceeding in respect of such issues determined by the Court of Appeals;

(C) whether the Commission's decision in a Section 11 proceeding involving a different holding company deemed to be decisive of the issues in the instant proceeding sets forth a "rule" or constituted merely an "adjudication".

(D) whether *Federal Communications Commission* v. *Pottsville Broadcasting Company*, 309 U. S. 134 (1940) defining the sphere of authority of the courts and the administrative agency where the Court of Appeals authority to review under the statute was specifically limited to questions of law is applicable to the Securities and Exchange Commission under the Act which grants the Commission the "exclusive jurisdiction to affirm, modify or set aside" the order of the Commission "in whole or in part" and does not limit the courts reviewing power or jurisdiction to questions of law.[4]

(2) Important issues involving the Standards of the Act are presented including:

(A) the decision of the Court of Appeals denying a right of withdrawal to dissenting stockholders is in

4. The question of the sphere of jurisdiction and authority of the courts and the Commission and the adjudicative and conclusory effect of the order of the reviewing Court of Appeals under the provisions of Section 24(a) of the Act is most important as these provisions are precisely similar to the court review by a court of provisions of all the legislation administered by the Commission: the Securities Exchange Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940, and consequently present questions which will be determinative of the effect of all reviewing orders of Court of Appeals *vis a vis* the Commission.

conflict with the decision in *Downing* v. *S.E.C.*, 203 F. 2d 611, C.A. D.C. 1953, cer. den. 346 U. S. 930 (1954) which permitted the transformation of *The United Corp.*, a holding company in reorganization under Section 11(b) of the Act into an investment company upon the specific condition that objecting stockholders have a right of withdrawal;

(B) the instant case is in direct conflict with other decisions of the Commission making such transmutation of holding companies into investment companies conditioned upon a right of withdrawal to objecting stockholders;

(C) the instant case is the first to be presented for review by this learned Court or by a Court of Appeals upon the issue whether a plan permitting a holding company in reorganization under Section 11(b) to be transmuted into an investment company without a right of withdrawal to objecting stockholders satisfies the Standards of the Act. In all other instances where a right of withdrawal was denied by the Commission to dissenting stockholders, the order of the Commission was never reviewed pursuant to the provisions of the Act by this learned Court or any other Court of Appeals;

(D) the instant case is the first case where

(i) the holding company to be transformed into an investment company had been under trusteeship to compel dissolution under Section 11(d) of the Act and the only management of such company for many years was said trustee without officers or directors or any right of stockholders to vote during the trusteeship;

(ii) where the management of the investment company will not be the incumbent management of the holding company;

(iii) where the Commission by its order, in essence, will transfer control and management of the investment company to be formed to a new controlling group which had no prior connection either

as the managers or as stockholders of the holding company;

(iv) the new controlling group acquired a controlling block of stock secretly and upon payment of substantial premiums, particularly without similar offers to other stockholders;

(v) where acquisition of control and such transfer would have violated Section 36 of the Investment Company Act had the holding company been a registered investment company; and

(vi) the interests of the new controlling group will be in conflict with the interest of the other shareholders of the investment company;

(E) the decision of the Commission and the Court of Appeals will have far reaching results in respect of the future interpretation and effectiveness of the Investment Company Act for:

(i) such decisions sanction and approve acts and transactions which would have been violative of that Act had the holding company been a registered Investment Company, and are violative of the spirit and intent of the Investment Company Act including secret acquisitions of control of investment companies, particularly by the payment of substantial premiums for controlling blocks of stock, "trafficking in investment companies" and "selling investment company stockholders up and down the river", and a denying to stockholders of the right to select the managements of their liquid funds, particularly where the nature of the business of the company is being changed;

(ii) the decisions of the Commission and the Court of Appeals will emasculate the salutary purposes of the Investment Company Act and may revive the major abuses rampant in the investment company industry prior to the enactment of this legislation; and

(F) the instant case presents most important issues in general corporate law involving the fiduciary duties of controlling stockholders and transfers of control of blocks of stock of corporations.

Statement of the Case

I. Description of IHES

(A) Nature of Organization, Activities and Status

IHES, created March 1929 as a Massachusetts Trust, was from its inception operated as, and its securities sold to the public as the securities of a public utility holding company. On February 2, 1939, IHES registered as a holding company under the Act. On July 21, 1942, the Commission pursuant to Section 11(b)(2) of the Act unconditionally ordered IHES to liquidate and dissolve upon various grounds including that IHES served no economic function (IHES *et al.*, 11 S.E.C. 888, 903-904).[5] This unequivocal order of dissolution and the findings and conclusions of the Commission on which it was found were affirmed in *Todd* v. *S.E.C.*, 137 F. 2d 472 (C.A. 6, 1943). On October 11, 1943, on Commission's application under Section 11(d) of the Act, the District Court assumed exclusive jurisdiction of IHES solely to enforce the dissolution order. On November 13, 1944, the Court appointed Bartholomew A. Brickley, Esq., as Trustee of IHES ("Trustee"), to take possession of the assets, to effect compliance with the dissolution order. The Trustee, without a board of directors or officers, constituted and still constitutes the management of IHES. The IHES stockholders had no vote during this entire trusteeship period and voted for the first time in April 1954, and then only to elect a so-called Interim Board of Directors of IHES, without management authority, with the sole function of submitting a plan to effect final compliance with the dissolution order.

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5. S.E.C. references are to bound volumes of Commission's Decisions and Reports.

(B) Capital Structure, Assets and Tax Advantages

The IHES capital structure, at present, consists only of one class of stock, namely, 856,718 shares of Class A stock. All other securities in the capital structure have either been redeemed, retired or cancelled in proceedings taken to effect dissolution under the Commission's original order. The IHES assets total about $30,000,000, and consist exclusively of cash and cash items and liquid and marketable securities, all listed on stock exchanges and susceptible of immediate distribution in kind, whereby simple and immediate compliance with the provisions and purposes of Section 11(b) of the Act can be effected by compliance with the original dissolution order.

It is claimed that IHES has a substantial tax advantage on its unrealized loss of about $30,000,000 on its holdings of New England Electric System ("NEES") common shares. IHES can sell these NEES shares, realize a net capital loss equal to the amount of its net income and capital gains and make distribution to its shareholders not subject to tax as ordinary income, but in reduction of the tax base of their IHES shares and any excess of distribution over its base would be taxed as long-term capital gain.

II. Background and Facts

(A) Prior Proceedings

During the trusteeship, every step, transaction and proceeding by the Trustee was unequivocally to effect compliance with the dissolution order until IHES reached its present status of one class of stock outstanding and all its assets liquid and fungible and distributable. Subsequent to the entry of the original dissolution order as affirmed, the Commission denied an application of Paul H. Todd ("Todd"), a Class A stockholder, to vacate the

dissolution order and to permit IHES to continue in existence based upon the grounds that IHES had simplified its system and corporate structure, had substantially improved its financial condition, had economic justification for its existence and, most important, IHES had a tax advantage in its unrealized loss on NEES stock which would be lost to IHES stockholders on dissolution, precisely the same tax advantage which formed the basis of the instant application to continue IHES as an investment company. The Commission denied the application upon the grounds that IHES had no economic justification and that tax advantages could not defeat the purposes of the Act. This order was affirmed in *Protective Committee for Class A Stockholders* v. *S.E.C.*, 184 F. 2d 646 (C.A. 2, 1950) the Court affirming the finding that IHES had no economic justification and the tax advantages were doubtful and did not constitute a basis for vacating the dissolution order.

In March 1953, a group of holders of IHES Class A shares agreed to urge upon the Commission the objective of converting IHES into an investment company. The Trustee accordingly filed an amended plan which provided for an election of an Interim Board of nine members with only the authority to formulate a plan for final compliance with 11(b)(2) of the Act and stated without any details as an objective the continuance of IHES as an investment company.

(B) The Instant Proceedings

Although the Class A stockholders to this March 1953 agreement had cooperated in all prior proceedings to obtain the best result for that class, each stockholder was independent, his holdings of shares disclosed, no individual or group had a controlling block of stock or intended to control IHES, its board of directors or its management were IHES to convert into an investment company. These

Class A stockholders desired that the board of directors and management be representative of all the Class A stockholders, large and small; that no individual or group dominate the board of directors; and that the District Court to insure proper representation of the public stockholder designate two candidates for the board (pp. 70-78, 84).

A Commission order, approved by the District Court November 16, 1953, directed an election by the Class A stockholders of an Interim Board on April 27, 1954. Soon after this court order, one, William Jacobs ("Jacobs") acting for two family groups ("Jacobs Group"), made up of the "Normans", seven brothers and sisters of the Norman family, and the "Wertheims", the present and former partners of Wertheim & Co., members of the New York Stock Exchange, entered the picture. Jacobs apparently planned to acquire for these families control of IHES as a vest pocket tax-free dividend paying investment company, and to do so quickly and secretly so that the other stockholders who had long been associated with IHES would be confronted with a *fait accompli*. To that end, after purchasing 10,000 Class A shares on the New York Stock Exchange during November and December 1953 "to test the market", he secretly acquired on January 21, 1954, in a single transaction and as one block, a controlling block of 250,000 Class A shares, or about 30% of the total outstanding (286-289, 356-366). None of the Jacobs Group had ever before been in any wise connected with IHES nor ever owned a single share of IHES stock. The plan of the majority of the Interim Board, approved by the Commission, is the plan of the Jacobs Group, and control of the investment company to be formed will be turned over to this group.

Jacobs, an investment adviser for the past 25 years, virtually his entire professional career, had only one client, the Normans, to whom he was devoted and owed a

high fiduciary duty as their investment adviser and as trustee of their various trusts and estates. The Normans are not engaged in any industry or other gainful occupation except the investment of their funds in securities. In essence, the Norman fortune constituted a private investment trust of which Jacobs was the sole investment adviser with broad discretionary powers. The magnitude and ramifications of this private investment trust and its conflict of its interests with the interests of other IHES stockholders in an investment company to be formed can be gleaned from the fact that the Norman interests only in other investment companies were 200,000 shares of Pennroad Company, with a market value of $3,500,000; an $1,500,000 investment in the Graham-Newman Company; and a substantial interest in the Lehman Corporation. In addition, the Normans had substantial investment holdings in industrial companies, the extent of which Jacobs refused to disclose. Jacobs himself is a member of the board of directors of the investment companies, Pennroad and Graham-Newman and of other investment companies. Jacobs admitted that prior to the purchase of the 250,000 IHES shares, he had agreed with the Wertheims that Wertheim & Co. would get IHES brokerage business (304-326, 336, 356-373).

The other Class A stockholders who had worked for years in behalf of the Class A stockholders refused supinely to accept his overnight secret grab for control and the domination of IHES by two families whose pecuniary interest, investment policy, stock activities and tax problems might be in basic conflict with those of other stockholders. A proxy contest developed between a Jacobs slate, hand-picked by him, and an opposition slate consisting primarily of independent stockholders who had long been associated with IHES throughout its proceedings. The election with cumulative voting was most close, five Jacobs nominees and four nominees opposed to Jacobs

were elected. A swing in the votes of less than 1,000 shares would have elected a majority of five directors opposed to Jacobs. The minority directors by petition to the District Court challenged the regularity of the election of the Jacobs directors. On December 8, 1954, the District Court approved provisionally an Interim Board of nine, five from the Jacobs slate and four from the opposition, who had received the greatest number of votes, to formulate a plan of final compliance with the Act.

III. Plans Proposed Under Section 11(d)

(A) The Trustee's Plan

The Trustee merely proposed that the Commission's dissolution order be modified so as to permit IHES to continue as a closed-end non-diversified investment company without any detail as to implementation or protective provisions.

(B) The Various Other Plans

The Interim Board Plan approved by five members of the board who were on the Jacobs slate proposed that IHES, as a Massachusetts voluntary association, be continued as an investment company. No right of withdrawal or appraisal is accorded to non-concurring IHES stockholders. No vote of IHES stockholders is required on this conversion.

Equity, which owns about 35,000 Class A shares, urged that the Commission's valid outstanding dissolution order of IHES, affirmed by the Court of Appeals, could not and should not be modified because these affirmances deprived the Commission of jurisdiction to continue the existence of IHES; were conclusively binding on all the issues in the instant proceeding; the dissolution order effectuated the mandate of Section 11(b) in accordance with the standards of the Act, by the simple and expeditious means

of an immediate and complete distribution of the liquid assets of IHES (cash and highly marketable securities) pro rata to Class A stockholders (the only class of security outstanding).

Equity urged that assuming the Commission did have jurisdiction to modify, then that the Interim Board Plan sponsored by the Jacobs Group is not fair and equitable because it did not grant a right of withdrawal to dissenting stockholders nor was the approval of this plan in the public interest or interest of investors by reasons of secret acquisition of control of IHES by the Jacobs Group, the impossible schism in the Interim Board and the conflicts between the interests of the Jacobs Group and the other IHES stockholders.

Equity proposed that if IHES be continued as an investment company, then the only plan which could comply with the standards of the Act and with the spirit and intent of the Investment Company Act would be a plan in which shareholders with complete disclosure of the facts should have the basic right to select their management by a vote on a Jacobs slate and an opposition slate. The slate receiving the majority was to control IHES and the minority to control a second investment company to be spun off from IHES, with the IHES assets to be distributed in kind between the two companies in the ratio of the vote between these two groups. Those stockholders who do not desire the management of either group are to have a right to tender their stock and receive their portion of the IHES assets. After amendment, the plan of Johnson and Central-Illinois approved by four members of the Interim Board became similar to the proposal of Equity. Stockholders with holdings of almost half of the outstanding IHES stock were opposed to the Interim Board Plan. Yet the Commission modified the dissolution order of IHES: permitted IHES to convert to an investment company; and denied to non-assenting stockholders a withdrawal right.

ARGUMENT

I

(A) The Commission had no jurisdiction to modify the Commission's prior order directing under the Public Utility Holding Company Act the dissolution of a holding company and continue the existence of such company as an investment company:

(1) After such dissolution had been affirmed by a Court of Appeals;

(2) After another Commission order had denied an application to modify such dissolution order to continue to permit the existence of such company and such order denying such application had been affirmed by a Court of Appeals;

(3) After the entry of a District Court order made upon the application of the Commission vested that Court with exclusive jurisdiction of the company for the sole purpose of enforcing the dissolution order; and

(4) No application had been made to any of these courts to vacate or modify their respective orders directing dissolution or for leave to institute the instant proceeding to vacate and modify such dissolution orders as affirmed to continue the existence of this company.

(B) These prior court orders are *res adjudicata* upon all the issues in the instant proceeding including the dissolution of the company.

The Commission's original dissolution order of July 21, 1942 was unequivocal:

> "ORDERED, pursuant to Section 11(b) of the said Act, IHES liquidate and dissolve."

This order was affirmed in *Todd* v. *S.E.C.* 137 F. 2d 475 (C.A. 6, 1943).

Thereafter, the District Court entered under Section 11(d) upon the Commission's application a decree assuming exclusive jurisdiction of IHES to enforce dissolution and appointed a Trustee of IHES and its assets for the purpose of such enforcement. This decree in essence reaffirmed the original dissolution order.

The Commission's original adjudication to dissolve IHES, affirmed by the Court of Appeals, was reaffirmed by the Commission in its order dated December 7, 1949 denying the Todd application to modify the dissolution order because of changed circumstances and to permit the continued existence of IHES and thereby preserve the tax advantages inherent in the unrealized loss in the NEES stock.

The Commission holding that improvement of the financial condition and the simplification of the system and structures did not require a modification of the dissolution order to permit the continued existence of IHES stated:

> "It will be noted in this connection that the history of the utility industry's compliance with the standards of Section 11(b) has in general been substantially similar to the history of this case. Compliance with the ultimate directive under Section 11(b)(2) has been preceded normally by a progressive rehabilitation of the system structures. This is necessary so that public investors will receive securities of a soundly capitalized enterprise, either of the holding company if it is to be recapitalized, or of the subsidiaries, if the holding company is to be dissolved. The financial improvements which are a consequence of this progressive rehabilitation are not, however, a justification for an abandonment of the ultimate result required by Section 11(b)(2)."

With respect to the loss of IHES tax advantages through dissolution, the Commission held these tax advantages existed when the Commission issued its original dissolution order; that tax advantages could not be the basis or justification for non-compliance with the provisions of Section 11(b)(2); that these tax advantages were speculative and not of such a nature to justify a modification of the dissolution order.

This order was affirmed in *Protective Committee* v. *S.E.C.*, 184 F. 2d 642 (C.A. 2, 1950), the court holding that there was no economic justification for the continued existence of IHES (p. 646):

> "and that in the case at bar the Commission was right in finding that there was no such 'justification' for the 'continued existence' of the International Hydro-Electric System."

The Court discussing the tax aspects as one of the reasons urged to prove that the continued existence of IHES has not become "unnecessary" stated (p. 648):

> "One is that the company has suffered a large loss in its holdings of New England Electric System, which can be made available to the company's shareholders as tax deductions, only if the share be distributed or sold; * * * It seems to us at best open to debate whether a saving of taxes to shareholders of a holding company is any ground, or at least a compelling ground, for continuing its existence, when otherwise it should be dissolved. However, we need not decide that question, and we do not, because in the case at bar the Commission has found—upon evidence that it was free to accept—that only the larger shareholders of International Hydro-Electric System could save upon their taxes if the shares of the New England Electric System were not distributed or sold. Even though we were to assume that a tax saving by shareholders is even a proper ground for finding that the simplification of a holding company's 'capital structure' is 'un-

> necessary' certainly we should not be justified in saying that a savings in taxes only by a part of the shareholders compels such a finding * * *"

The determinative nature of the adjudication on the Todd application is emphasized in a prior Commission's opinion:

> "In connection with the proposal * * * of the Trustee's plan that IHES continue as an investment company it may be noted that * * * we rejected an application made by Paul H. Todd, a Class A stockholder, that IHES, after disposing of its domestic utility subsidiaries, be permitted to continue in existence as an exempt holding company over Gatineau, so that the IHES stockholders could avail themselves of the potential tax benefits in the form of dividends not taxable as ordinary income to be derived from capital losses on the sale of IHES' holdings of NEES stock. * * *"

The only justification by the Commission of its instant order modifying the dissolution order and continuing IHES as an investment company is the tax advantages that might accrue to the stockholders. The Commission in its opinion stated:

> "And once exempt it can serve a useful purpose by operating as an investment company and thereby affording its stockholders a means of availing themselves of the favorable tax situation with the contingent asset that it provides, which would be lost if IHES were liquidated.

The *sine qua non* of the Commission's instant order is that the continued existence of IHES is reasonably justified by the existence of these tax benefits.

The Commission is deprived of jurisdiction to modify its prior order of dissolution and is conclusively bound by the adjudication in the two prior orders of affirmance by Courts of Appeals, and by the decree of the District Court

vesting it with exclusive jurisdiction to effectuate dissolution that there is no economic justification for the continued existence of IHES, and that the tax advantages in IHES were speculative and, in any event, did not constitute a ground for the modification of the dissolution order.[6]

The Commission in its opinion merely assumed a power to modify the IHES dissolution order (p. 7):

> "We may modify an order previously made under Section 11(b)(2) of the Act if, we find 'that the conditions upon which the order was predicated to not exist'."

Bailey v. *Proctor*, 166 F. (2d) 392, (C.A. 1, 1948), involving the Aldred Investment Trust ("Aldred") is decisive on the issues whether the Commission is without jurisdiction or authority to modify the dissolution order after affirmance by a Court of Appeals and whether an application must be made to the Appellate Court for leave to file a new plan. In this action by the Commission, the court enjoined the management of *Aldred*, a registered investment company, from further acting for the trust on the grounds of gross abuse of trust under Section 36

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6. Doubt upon the Commission's power to continue the existence of IHES by reason of the outstanding dissolution order existed in the mind of its Chairman:

> "Chairman Armstrong: In other words you want two resulting companies. You also want a right of withdrawal?
>
> Mr. Schenker: That is exactly right.
>
> Chairman Armstrong: How do you reconcile that with the observation that there is a pending order of dissolution? How do you get away from that order of dissolution?
>
> Mr. Schenker: Frankly, I think that this is a question that the Commission has to ask itself, and we raise that point in our brief. We question the Commission's right." (Tr. pp. 95-96, July 6, 1955)

The petitioner raised before the Commission the lack of jurisdiction of the Commission to modify its order:

> "Mr. Schenker: I want to give you a citation, Bailey against Proctor, 166 Federal (2d) 392." (Tr. p. 129, July 6, 1955)

of the Investment Company Act of 1940, 54 Stat. 841, 15 U.S.C.A. §80a-35. Receivers were appointed to *reorganize or liquidate* the trust.[7] Thereafter the District Court entered a judgment disapproving various plans of reorganization and ordering liquidation of the trust. This judgment was affirmed and the case remanded for further proceedings.[8] Subsequently, appellants moved the District Court to modify the judgment ordering liquidation and to permit *Aldred* to continue its existence upon the condition that each shareholder be paid the pro rata liquidation value of his shares unless he elected to continue as a shareholder.

Upon appeal, the court stated at page 395:

> "(1) In the absence of an appeal from the prior judgment, the district court would have complete power to consider the new plan submitted to it, despite its earlier order of liquidation. A court has power to modify its prior judgments or orders in cases still pending as long as no final order has been issued, and the jurisdiction of the court continues. Neither the 'term rule' nor Rule 60(b), Federal Rules of Civil Procedure, 28 U.S.C.A. following section 723c, precludes this. (citing numerous cases and authorities.) *The receivers, contend that the district court has no such power in the present case to modify its prior judgment since it was affirmed by this court in Bailey* v. *Proctor, supra. The contention is that this court affirmed an order of liquidation and that the district court is powerless to consider a plan which does not provide for liquidation, but instead allows continuation of the trust.*" (Italics ours)

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7. *Aldred Investment Trust*, C. C. Mass., 1945, 58 F. Supp. 724 aff'd 1 Cir., 1945, 151 F. 2d 254, cer. den. 326 U. S. 795, 66 S. Ct. 486, 90 L. Ed. 483. This case is most important because the main claim of gross abuse of trust was the secret acquisition of control of this trust by a new management and the subsequent investment of a substantial portion of its assets in a race track.

8. *Bailey* v. *Proctor*, 160 F. (2d) 78, C.A. 1, cert. den. 331 U. S. 834, 67 S. Ct., 1515.

The court concluded that the District Court had no power to consider new plans for continuation of the trust after the affirmance of the order of liquidation stating (p. 396):

> "*We are inclined to think that the proper course of action would have been for the appellants to petition us for leave to file the new plan with the district court for its consideration, if they thought the circumstances had so changed as to require a modification of that order. Since this was not done, we could dispose of the case on the ground that the district court was powerless to modify its order. But this question was not raised before the district judge and he evidently assumed that he had power to grant the petition. He considered the plan on its merits and decided not to vary the liquidation order.*" (Italics ours)

The Commission's jurisdiction in the original IHES Section 11(b)(2) proceeding was similar to those of the District Court in the *Aldred* receivership—jurisdiction to "reorganize or liquidate" and enforce compliance. Although the Commission could have originally provided that IHES after simplification of its system and structure be continued as an investment company, the Commission ordered dissolution; and as in the *Aldred* case, this dissolution order of IHES was affirmed by a Court of Appeals.

Under the *Bailey* case the Commission was deprived of jurisdiction to vacate the dissolution order and to continue the existence of IHES by reason of (a) the order of the Court of Appeals in *Todd* v. *S.E.C.*, *supra*, affirming that dissolution order; (b) the order of the Court of Appeals in *Protective Committee* v. *S.E.C.*, *supra*, affirming the Commission's order denying the application of a Class A stockholder to modify the dissolution order and continue the existence of the company to preserve the tax benefits,[9] and (c) the decree vesting the District Court

9. The question of the Commission's power to modify its order of dissolution after affirmance by the Court of Appeals, 6th Cir. was not raised in the case of *Protective Committee* v. *S.E.C.*, *supra*.

with exclusive jurisdiction of IHES only to enforce this dissolution because so long as this decree was outstanding, the Commission could not enlarge its jurisdiction to substitute for dissolution any plan of reorganization including conversion into an investment company even though such plan might have been another method of effecting Section 11(b)(2).

Section 11(b)(2) granting the Commission the power to modify any order previously made "if the Commission finds that the circumstances have changed," does not vitiate the applicability of the *Bailey* case, because it is merely a statutory enactment of the power that would be inherent in the Commission under that section and confers no more power upon the Commission than those possessed by the District Court in the *Aldred* case to modify before affirmance its order under changed circumstances. The Commission, absent the orders affirming dissolution, may have had power to modify its order upon proof of changed circumstances but like the District Court in the *Aldred* case, the Commission was deprived of this power after affirmance.

The Court of Appeals in the instant case discussing the jurisdiction of the Commission and the conclusory effect of the affirmance of the order of dissolution merely stated:

> "Appellants have misconceived our holding in *Bailey* v. *Proctor*, 166 F. 2d 392 (1948), in relying upon that case as authority for the proposition that the Commission needed to obtain prior leave from the Court of Appeals for the Sixth Circuit before proceeding to modify its dissolution order of July 21, 1942. See *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 140-44 (1940)."

The instant proceedings present most important questions of administrative law: the spheres of authority

which the Congress has given to the courts and the Securities and Exchange Commission under all the acts administered by it; the scope and effect of the *Pottsville* case on the Commission as an administrative tribunal; extension of the *Pottsville* case relating to a statute limiting reviews by the court of orders of an administrative agency to questions of law to statutes as in the case at bar not so limiting reviews by the courts.

The *Pottsville* case does not dissipate the petitioner's contentions that the orders of affirmance deprived the Commission of jurisdiction to modify the dissolution order and are *res adjudicata* upon the issues in this case. In that case,[10] the Court of Appeals reversed the Federal Communications Commission's denial of the application of The Pottsville Broadcasting Company for a permit to construct a broadcasting station upon the ground that the Commission's conclusion as to respondent's lack of financial qualification was based on an erroneous understanding of the Pennsylvania law and ordered the "cause remanded to the Communications Commission for reconsideration in accordance with the views expressed." On this remand, the Commission instead of granting respondent's original application considered also two rival applications. Upon appeal from a writ of mandamus of the Court of Appeals commanding the Commission to reconsider only the application of The Pottsville Broadcasting Company on "the record as originally made and in accordance with the opinions" of the Court of Appeals in the original review, this learned Court stated:

> "Under the Radio Act of 1927 as originally passed, the Court of Appeals was authorized in

10. This learned Court stated: "and, because important questions of administrative law are involved, we brought the case here. We are called upon to ascertain and enforce the spheres of authority which Congress has given to the Commission and the courts, respectively, through its scheme for the regulation of radio broadcasting in the Communications Act * * *."

review action of the Radio Commission to 'alter or revise the decision appealed from and enter such judgment as to it may seem just.' §16 of the Radio Act of 1927, 44 Stat. 1169. Thereby the Court of Appeals was constituted 'a superior and revising agency in the same field' as that in which the Radio Commission acted. *Radio Comm.* v. *General Electric Co.*, 281 U. S. 464, 467. Since the power thus given was administrative rather than judicial, the appellate jurisdiction of this Court could not be invoked. *Radio Comm.* v. *General Electric Co.*, *supra*. To lay the basis for review here, Congress amended §16 so as to terminate the administrative oversight of the Court of Appeals. c. 788, 46 Stat. 844. In 'sharp contrast with the previous grant of authority' the court was restricted to a purely judicial review."

* * * * *

"The Commission originally found respondent's application inconsistent with the public interest because of an erroneous view regarding the law of Pennsylvania. The Court of Appeals laid bare that error, and, in compelling obedience to its correction, exhausted the only power which Congress gave it. * * * The fact that in its first disposition the Commission had committed a legal error did not create rights of priority in the respondent, as against the later applicants, which it would not have otherwise possessed. Only Congress could confer such a priority. It has not done so."

In the *Pottsville* case, the amended Section 16 of the Radio Act provided:

* * * * *

"(d) the court * * * shall have power, upon such record, to enter a judgment affirming or reversing the decision of the commission * * *: *Provided, however*, That the review by the court shall be limited to questions of law and that findings of fact by the commission, if supported by substantial evidence, shall be conclusive unless it shall clearly

> appear that the findings of the commission are arbitrary or capricious. * * *"

In the case at bar, Section 24(a) of the Act does not limit the court to a review of questions of law but provides:

> "Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order, in whole or in part."

It is submitted that the jurisdiction and powers of the Court of Appeals under Section 24(a) of the Act are similar to the Court of Appeals under the original Section 16 of the Radio Act and consequently, the Court of Appeals was constituted "a superior and revising agency in the same field" as the Commission with the power of "administrative oversight" of the orders of the Securities and Exchange Commission. It is submitted that in the instant case, unlike the *Pottsville* case, the orders of the Court of Appeals affirming the order of dissolution and denying a modification of the dissolution order to continue the existence of IHES respectively deprive the Commission of jurisdiction to modify said orders and are *res adjudicata* upon the issues.

Even if it be assumed that these prior orders are not *res adjudicata*, they create an equitable estoppel barring any modification of the dissolution order. Equity takes at least the position which the Commission in its opinion on the Todd application asserted the preferred stockholders group took, namely:

> "the preferred stockholders group has maintained that a doctrine in the nature of res adjudicata requires the Commission to adhere to a policy of not reviewing its orders except for the gravest reasons and under exceptional circumstances, which the group claims do not exist here. This group also contends that a doctrine in the nature of estoppel

bars modification of our order in the interest of investors who have traded in IHES securities in reliance upon the finality of the order."

All prior transactions, approved by the Court and the Commission with the avowed purpose to compel dissolution resulted in the reduction of IHES assets to a liquid and distributable condition. No complicated problems of evaluations, appraisals or allocations remain. Compliance with the dissolution order will immediately effect the purposes and meet the standards of the Act, resulting in fair and equitable treatment of all IHES stockholders. The dissolution order should not be modified.

II

The standards of the Act requiring a plan to be fair and equitable, necessary and appropriate, in the public interest and in the interest of investors were violated by the Acts committed and conditions created by the proposed new management group which are in conflict with the spirit and intent of the Investment Company Act.

The approval of the Jacobs group plan has been based in large measure upon the fact in a "proxy contest" control of the board was won by that group. The Commission, regardless of the result of any proxy contest, had an absolute and independent statutory duty to ascertain whether the plan as proposed and the acts of and the conditions created by the successful contestant violated in any respect the broad standards of the Act.

(A) The Secret Acquisition of and the Premiums Paid for the IHES Stock.

The Jacobs Group acquired secretly in a single transaction a controlling block of 250,000 shares shortly before the election of the Interim Board without any similar offer

to purchase from other stockholders. The group also purchased 13,274 additional shares paying a price much in excess of the asset value and market price of the stock.

(B) The Conflicts of Interest Between the Jacobs Group and the Other Stockholders.

The position of control of Wertheim & Co., brokers and investment banks, creates conflicts of interest inherent in broker domination of investment companies with their potential brokerage and investment bank business. The Norman family are really a private investment trust managed by Jacobs whose judgment on the investment and dividend policy of IHES must necessarily be affected by the investment requirements and tax problems of the Normans. Jacobs, representing the Normans as a director of Pennroad Corporation, an investment company, admitted there had been times when the Norman interests conflicted with those of the other Pennroad stockholders but stated that he always subordinated his client's rights. In Pennroad, the Normans were not controlling stockholders and could not dictate the constituency or veto the act of the board of directors. In IHES, the Jacobs Group will be controlling stockholders and will be able to impose, we submit, their will upon the company.

These most vital objections—abuses in acquisition of control and conflicts of interest—are disposed of summarily in the Commission's mere statement in its opinion that the secret acquisition of controlling blocks are not illegal and need not be disclosed, and that there was no proof that the Jacobs Group would operate the company other than in the best interest of all stockholders (pp. 19-20):

> "Equity and Johnson assert that they consider the Jacobs group unqualified to control the management of the investments in IHES. They question the manner in which that group acquired shares of IHES stock, and argue that since the members of the Jacobs group have other investments and busi-

ness interests they will necessarily operate IHES in a manner more to their own interest. Jacobs first entered the IHES picture late in 1953, when he purchased 10,000 shares of Class A stock in a stock exchange transaction acting principally for a family group who have stockholdings in other investment companies and whose investments he manages, and for a securities firm and its partners and associates. In January 1954 he purchased a block of 250,000 shares from five to seven stockholders in a transaction off the exchange. Subsequently an additional 13,274 shares were acquired in two transactions at a price in excess of the current market price. The purchase of the 250,000 share block is criticized because it was made without notice to or consultation with the large stockholders of IHES. Although it would appear that this entire matter is irrelevant in the context of the problem before us, in any event, we find no evidence of illegality in the acquisitions and it does not appear in the circumstances that it was incumbent upon the purchasers to announce their intention to buy the shares. And with respect to the other interests of the Jacobs group, no evidence was introduced which would support a finding that that group will operate IHES other than in the best interest of all stockholders."

This admitted marked conflict is sufficient to deny to the Jacobs Group control of the minority stockholders' funds without affirmative proof that that group will act in a manner detrimental to such minority stockholders. These stockholders should not be compelled by administrative mandate to be captive stockholders of an investment company where interests of the controlling stockholders conflict with other stockholders where the disclosure and voluntary subordination of the interests of that group is within their own complete discretion.

(C) The Commission's Approval Violates the Spirit and Intent of the Investment Company Act.

The Commission by approving the Jacobs Group plan has sanctioned practices and conditions which caused substantial losses to investors and brought the investment company industry in disrepute in the 1930's. The Investment Company Act is unique for an entire industry agreed to the necessity for and all the provisions of legislation regulating that industry. In view of the fact that investment companies are *sui generis* enterprises consisting of large liquid pools of funds, with the broadest discretionary investment powers in management, all agreed the investor should have the absolute unfettered right, using his own criteria, to select and there be no basic change without his consent the type of fund and the managers of his funds. Transfers of control are most serious when secret or the result of "insiders'" transactions and were universally characterized as "trafficking in investment companies" or "selling the stockholders down the river", and are particularly reprehensible.

The same principles are involved in the instant case where a transfer of management or control is being effected by an administrative mandate, particularly where such transfer is to a group who secretly acquired a controlling block.[11] Broad principles of law and not personalities involved must determine whether control shall be transferred by administrative mandate compelling investors to accept persons to whom they are opposed as managers of their liquid funds.

The entire spirit, intent and history of the Investment Company Act is unequivocally opposed to the existence

11. Earle Bailie, spokesman for the industry testifying on prospective legislation changing then existing managerial and controlling relationships, testified: "How will they justify to the stockholders of these companies this sell 'down the river' by a governmental body * * *" The Commission and the Congress acceded to this argument and the legislation did not provide for compulsory change in the then existing managerial or controlling relationships.

of conflicting interest and to transfer of control by the secret acquisition of controlling blocks of stock. The "Findings and Declaration of Policy" of the Investment Company Act leave no doubt on these issues:

> "SEC. 1.; * * *
>
> (b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—
>
> * * * * *
>
> (2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;
>
> * * * * *
>
> (6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;
>
> * * * * *
>
> It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors."
>
> * * * * *

The Commission in a release had previously denounced transfers of stock of corporations holding management contracts with investment companies as gross abuse of trust, which is equally applicable to transfers of controlling blocks of stock:[12]

> "The legislative history of Section 15 manifests a clear Congressional intention to prevent all trafficking in investment advisory contracts and to prevent an investment adviser from transferring his fiduciary obligations by turning over the management of the stockholders' money to a different person."

Secret acquisition of control, the payments of premiums on stocks and the secret agreement with respect to the IHES brokerage business by the Jacobs Group should not be sanctioned by approving the plan creating an investment company to be controlled by that group for such acts not only violate the spirit and intent of the Investment Company Act but had IHES been a registered investment company these acts would have constituted a gross abuse of trust under Section 36 of the Investment Company Act which provides:

> "SEC. 36. The Commission is authorized to bring an action in the proper district court of the United States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:
>
> (1) as officer, director, member of an advisory board, investment adviser, or depositor; or

12. Investment Company Act, 1940, Release No. 354, May 11, 1942.

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate."

(D) The Commission's Approval Sanctions Violations of Corporate Fiduciary Duties.

Furthermore that group violates its fiduciary duty imposed upon persons selling and persons purchasing a controlling block of stock, particularly of investment companies, to obtain for the other stockholders an offer to purchase their securities at the same prices. Recent decisions have imposed such a duty upon controlling stockholders. In *Perlman* v. *Feldmann*, 219 F. (2d) 173 (C. A. 2, 1955), cert. denied 349 U. S. 952, the court stated (p. 175):

"(1) Both as director and as dominant stockholder, Feldmann stood in a fiduciary relationship to the corporation and to the minority stockholders as beneficiaries thereof. People *v.* Litton, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281; Southern Pac. Co. *v.* Bogert, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099."

and discussing *Schemmel* v. *Hill*, 91 Ind. App. 374, stated at page 176:

"Although the Indiana case is particularly relevant to Feldmann as a director, the same rule should apply to his fiduciary duties as a majority stockholder, for in that capacity he chooses and controls the directors, and thus is held to have assumed their liability. Pepper *v.* Litton, supra, 308 U. S. 295, 60 S. Ct. 238. This, therefore, is the standard to which Feldmann was by the law re-

> quired to conform in his activities here under scrutiny."

For other authorities dealing with fiduciary duty of controlling stockholders or transfers of control and payments of premium:

See *Securities & Exchange Commission* v. *Aldred Investment Trust*, 58 Fed. Supp. 724, aff'd *Aldred Investment Trust* v. *Securities & Exchange Commission*, 151 F. 2d 254, cert. denied 326 U. S. 795, dealing with the acquisition of control as constituting a gross abuse of trust and a violation of Section 36 of the Investment Company Act sufficient to warrant the intervention of the Commission. *Insuranshares Corp'n of Delaware* v. *Northern Fiscal Corp'n*, 35 Fed. Supp. 22 (E. D. Pa.); *Dannett* v. *Arn*, 71 F. 2d 912 (C. A. 10); *Roby* v. *Dunnett*, 88 F. 2d 68 (C. A. 10, 1937), cert. denied 301 U. S. 706; *Sautter* v. *Fulmer*, 258 N. Y. 107; *Am. Trust Co.* v. *Calif. Western State Life Ins. Co.*, 15 Cal. 2d 42; Berle and Means, The Modern Corporation and Private Property, 244.

See also, articles by Vanderpoel, Chicago Sun-Times, Finance Section, September 9 to October 10, 1951, particularly October 10, 1951, page 47:

> "There is a unanimous conviction on the part of those who have taken special interest in small stockholders that it is unethical for a management group to sell control of a company to outside interests on terms not made available to all stockholders."

(E) Commission's conflicting position in other pending proceedings involving instant issues.

Petitioner's counsel urged upon the Commission and the courts below that the approval of the plan with its implied sanction of secret acquisitions of control, payment of premiums for such control stock, basic change of a

holding company into an investment company, particularly with no right of withdrawal to objecting stockholders not only violated the spirit of the Investment Company Act but would plague the Commission in its future administration of that act.[12] Most recently, in August 1956, the Commission instituted an action[13] under Section 36 of the Investment Company Act upon the grounds that the sale at a premium of the controlling stock of a management investment company, the principal asset of which was a management contract with an investment trust, constituted an assignment of the management contract and a gross abuse of trust. The Commission made no claim that the new management had been guilty of any dishonest or improper acts in actual management of the funds of that trust.

At about the time[14] that the Commission was urging upon the Court of Appeals below that the standards of the Act or of the Investment Company Act were not violated by a secret acquisition of a control of IHES because such acquisition was not illegal nor by conflicts of interest because there was no proof that the Jacobs Group would act contrary to the best interests of all stockholders, the Commission was urging emphatically upon the District Court in California that the transfer at a premium of the controlling block of stock of the management company was a gross abuse of trust even though there was no claim of wrongful conduct with respect to the funds.

The brief of the Commission was based upon the contentions of the petitioners herein that the sale of the

12. Tr. p. 129, July 6, 1956.

13. United States District Court for the Northeastern District of California, Southern Division, Securities & Exchange Commission, plaintiff, *v.* Insurance Securities Incorporated, et al., defendants (Civil Action No. 3574).

14. The Commission's brief before the District Court was dated October 23, 1956, which was after the argument in the Court of Appeals in IHES on October 4, 1956 and decided October 26, 1956.

block of stock violated the spirit, intent and background of the investment company legislation because it was tantamount to "trafficking in investment trusts" and in addition violated broad general corporate fiduciary principles.[15] The Commission in its brief stated (p. 14):

> "The legislative history revealed the many evils and abuses that had resulted from the trafficking in investment advisory and principal underwriting contracts. These contracts were normally held or controlled by sponsors of investment companies or those closely allied with them. They were frequently sold for substantial amounts to purchasers eager to acquire control of investment companies, and the consequent shift in control exposed public investors to a new management which often exploited their new position for its own particular benefit."
>
> * * * * *
>
> "Defendants argue that no actionable wrong under Section 36 was involved here because the transactions were with outsiders and not with the Trust Fund, and because there was no diversion or use of trust assets (Defendants' Memorandum, pp. 15-16). We submit that these are not the only ones for which a fiduciary may be called to account, and in enacting Section 36, as we have noted, the Congress laid down no such limited standard. See Union Pacific Railway Co. *v.* Chicago, etc. Railway Co., 163 U. S. 564, 600-601 (1895). That the concept of fiduciary duty is much broader as illustrated by Young *v.* Higbee Co., 324 U. S. 204 (1945)" (p. 20).

Similarly, in another proceeding now pending before the Commission for approval of a sale of stock of the

15. The California District Court, Goodman, D. J., on November 29, 1956, dismissed the Commission's complaint principally upon the ground that there was no claim that the new managers had acted dishonestly with respect to the management of the funds. Decision is not yet reported.

Investors Diversified Services, the staff urged upon the Commission to disapprove the transfer of such stock upon the ground that it was tantamount to trafficking in investment companies.[16]

Although these issues of trafficking in investment companies and conflicts of interest and breach of general corporate fiduciary principals were dealt with at length in the brief in the Court of Appeals below, the court did not discuss any of these issues but merely contented itself with stating:

> "Other contentions by appellants have been considered, but we think they do not have sufficient merit to call for special discussion."

It is submitted that the instant case presents most vital questions affecting not only the future administration of the Public Utility Holding Company Act but also of the Investment Company Act and should be passed upon by this learned Court.

III

The denial to dissenting stockholders of the right of withdrawal violates the standards of the Act.

The decision in the Court of Appeals denying to dissenting IHES stockholders a right of withdrawal is in conflict with *Downing* v. *S.E.C.*, 203 F. 2d 611 (D.C. Cir. 1953), *supra*, where transmutation of The United Corporation, a holding company into an investment company was conditioned upon a right of withdrawal to objecting stockholders, and with its own prior decision in *Bailey* v. *Proctor*, 166 F. 2d 392, *supra*, where the modification of the order of liquidation and continuance of the existence of *Aldred* was conditioned upon a right of withdrawal

16. Wall Street Journal, Friday, December 7, 1956, page 14, first column.

even though none of the objectionable factors present in the IHES case—conflict of interest, schism in the board of directors, secret acquisition of control and payment of premiums were present in the *Aldred* case. In the *Bailey* case, the court stated:

> "[3] So considering the question, we think the trial judge abused his discretion in not approving the plan. All the former objections to the continuation of the trust have been removed. The debenture holders have been paid in full; thus, there is no question of the shareholders speculating with other people's money. *All shareholders who desire to withdraw will be allowed to do so and will receive their full pro rata share.*
>
> • • • • •
>
> *"We can see no real objection to the new plan. It appears to deal fairly with the interest of all concerned. Since no one will be injured, we see no reason not to allow the present equitable owners of the trust property to decide what to do with their own money."* (Emphasis ours)

The Court of Appeals denied a right of withdrawal because there was "no specific statutory requirement that a plan under §11(b), to be approved as fair and equitable, must contain a provision permitting withdrawal by dissenting stockholders." It is vital to note that the Act does not contain any itemization of specific provision which are deemed to be necessary to make a plan to make such plan fair and equitable; but merely sets forth the broadest statement of standards—"fair and equitable", "necessary and appropriate" and "in the interest of investors" and "in the public interest." Furthermore, since the Act does not provide for transmutation into an investment company as a means of effectuating the provisions of Section 11(b) but such transmutation has been permitted upon the basis of the legislative history of the Act, there would be no occasion specifically to provide for

a right of withdrawal in the Act. The court argued that appraisal rights of dissenting stockholders as provided for in Massachusetts law relating to corporations do not extend to IHES organized as a Massachusetts trust. The fact is that the duty of the Commission is to determine the fairness and equitableness of a plan upon the facts prevailing in each case, and the absence under state law of a right of withdrawal does not render *ipso facto* a denial of such right to stockholders fair and equitable. Furthermore, as is admitted by the court, the IHES trustee had delegated all their powers to a board of directors and the trustee remained merely a custodian of its securities in the trust. IHES is a corporation "window-dressed" as a Massachusetts trust and the laws of Massachusetts relating to corporations in equity should be made applicable to the case at bar. The final argument of the court is that the board of directors by reason of the delegation to it of the broad powers of the trustee had the broadest discretionary powers to engage in almost any sort of business activity and this without the requirement of a favoring vote of the shareholders and without any obligation on the part of the trust to buy out a dissenting shareholder. The broad discretionary powers of the trustee delegated to the board of directors correspond to the usual "boiler plate" provisions in articles of incorporation with respect to the business and purposes of the corporation. These provisions were the basis of the major abuses extant in the 1930's in the investment company industry and were used as a justification by persons who changed the basic nature of the business of investment companies overnight without notice to their stockholders. It was these "boiler plate" provisions which gave rise to the specific legislation in the Investment Company Act relating to changes in the basic nature of the activities of investment companies.

As was testified to at the Senate Committee hearings by Hugh Fulton, Assistant United States Attorney who had prosecuted "looters" of investment trusts:

> "Senator Wagner: Is there any limit as to what their activities can be in relation to business transactions?
>
> Mr. Fulton: Of course, it would be impossible to say there is no limit, because it is not infinitive, but, as you know, as a lawyer, those charters contain page after page of the most broad general powers, so that the investment trust could buy, sell, and exchange almost anything for almost any purpose. The only limit that I know of is the limit that at some point * * * like the prosecution authorities would step in and say 'You have definitely done this with knowledge and intent to defraud the investment trust and not simply with mistaken business judgment.' That is the only limit I know of."

* * * * *

As was stated in the Report of the Committee on Banking and Currency submitted to accompany the Investment Company Act of 1940 (p. 7):

> "A major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced investment policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders. Similarly, after investors have invested in companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement of the companies."

Finally, the Investment Company Act, Section 13, prohibits a registered investment company unless authorized

by a vote of its outstanding securities to effect change in the investment policy of the company and the law makes the provision specifically applicable to common law trusts.

The court below further stated that many plans under 11(b) which did not afford a right of withdrawal to dissenting stockholders have been approved by both the Commission and the courts. This statement is ambiguous. The fact is the instant case is the first case to be passed upon by any Court of Appeals under the court review provisions of the Act where a right of withdrawal is denied to dissenting stockholders upon a transformation of a holding company into an investment company.

The court below did not distinguish the instant case from *Downing* v. *S.E.C., supra,* nor its own decision in *Bailey* v. *Proctor*, both of which granted dissenting stockholders a right of withdrawal.

CONCLUSION

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to the United States Court of Appeals for the First Circuit should be granted.

Respectfully submitted,

DAVID SCHENKER,
Counsel to The Equity Corporation, petitioner.

SCHENKER & SCHENKER,
Attorneys for The Equity Corporation, petitioner.

APPENDIX A

OPINION OF THE COURT OF APPEALS

October 26, 1956.

MAGRUDER, *Chief Judge.* Appellants in these cases, Central-Illinois Securities Corporation, a registered investment company, and C. A. Johnson, its president and principal stockholder, and The Equity Corporation, another registered investment company, are all stockholders of International Hydro-Electric System (hereinafter abbreviated to IHES), a registered holding company under the Public Utility Holding Company Act of 1935 (49 Stat. 803). The appeals are from an order of the United States District Court for the District of Massachusetts entered April 23, 1956, issued under §11(d) of the Act, approving and enforcing a plan of reorganization of IHES deemed to be a fair and equitable means of compliance with the corporate simplification requirements of §11(b) of the Act, in accordance with an order of the Securities and Exchange Commission, as modified.

IHES was organized as a Massachusetts business trust, under an original declaration of trust dated March 25, 1929, and since amended from time to time. The trustees, and by delegation the board of directors, were given the broadest discretionary powers to engage in almost any sort of business activity—this without the requirement of a favoring vote by the shareholders, and without any obligation on the part of the trust to buy out a dissenting shareholder. Thus, though IHES started out as a holding company in the public utility field, the trustees and/or the board of directors, if they deemed it advisable, were fully empowered to dispose of the utility subsidiaries of the trust and to transmute IHES into an investment company.

Appendix A

On June 17, 1940, the Securities and Exchange Commission instituted a proceeding under §11(b) of the Public Utility Holding Company Act to determine what action was necessary to be taken by IHES to comply with the simplification standards of §11(b)(2). Eventually, on July 21, 1942, after elaborate hearings, the Commission issued its Findings, Opinion and Order requiring that IHES be liquidated and dissolved, such liquidation and dissolution to be "carried out with care and in a manner which subserves the public interest in every particular." *International Hydro-Electric System*, 11 SEC 888. 908. On a petition by a shareholder of IHES for review of this Commission order, under §24(a) of the Act, the Court of Appeals for the Sixth Circuit upheld the Commission and directed that the shareholder's petition for review be dismissed. *Todd* v. *S.E.C.*, 137 F. 2d 475 (1943).

In view of the inability of the IHES management to come forward with a satisfactory plan for the orderly liquidation of the holding company, the Commission filed in the United States District Court for the District of Massachusetts an application under §11(d) of the Act asking for a court decree enforcing compliance with the Commission's dissolution order of July 21, 1942. The district court took jurisdiction of IHES and its assets and enjoined the debenture holders from filing suits for enforcement of their claims pending the orderly liquidation of the estate. In November, 1944, the district court appointed Bartholomew A. Brickley as trustee of the estate of IHES, and since then Mr. Brickley has continued actively in that capacity.

In 1947 the trustee and interested security holders filed various plans for a division of the assets and for dissolution of IHES. After extensive hearings, serious disagreements among the various classes of security holders be-

came apparent. In April, 1949, the trustee proposed a Second Plan, in four parts, for the liquidation of IHES. Parts I and II provided for the retirement of the IHES debentures and for a two-year bank loan. Part III provided for the issuance of trustee certificates to IHES preferred shareholders and Class A stockholders, and Part IV provided for distribution of the residue of the assets and dissolution of the enterprise. After Parts I and II had been duly approved by the Commission and the district court, a compromise agreement was executed on March 26, 1953, the terms of which were embodied in Part III (as amended) and Part IV (as amended) of the trustee's Second Plan. Part III (as amended) provided (a) for the retirement of the IHES preferred stock, and (b) for the election of an interim board of directors of IHES to consist of nine members, with the function of representing the stockholders in formulating a plan for implementing Part IV (as amended), which called for a request to the Commission to modify its flat dissolution order of July 21, 1942, so as to permit the continuance of IHES as a closed-end nondiversified investment company to be registered as such under the Investment Company Act of 1940. 54 Stat. 789. Be it noted that at the date of this compromise agreement of March 26, 1953, all the parties in interest were in apparent accord upon the desirability of modifying the Commission's dissolution order to permit survival of IHES as an investment company, and all assumed that the Commission had power to make such modification.

Meanwhile, in June, 1949, Paul H. Todd, a large stockholder in IHES, had proposed a plan to the Commission under which IHES would be permitted to continue in existence as an exempt holding company under §3(a)(5) of the Act, this on the argument that most of the abuses and violations of the Act pointed out in the Commission's

opinion supporting its 1942 dissolution order had already been eliminated. The Todd plan was supported by the IHES Class A stockholders but was opposed by the trustee, by the Commission's staff, and by the IHES preferred stockholders. An order was entered by the Commission disapproving the Todd plan. Upon a petition for review under §24(a) filed by the Class A Stockholders Protective Committee, the Court of Appeals for the Second Circuit sustained this order of denial by the Commission. *Protective Committee, etc.* v. *S. E. C.*, 184 F. 2d 646 (1950).

After that, Todd and the Class A Stockholders Protective Committee took a new tack and filed other plans for the continuance of IHES, now to be divested of other public utility subsidiaries and turned into an investment company, instead of remaining as an exempt holding company as previously proposed and turned down by the Commission. While these plans were pending, the trustee of IHES made arrangements for the disposition of its various domestic subsidiaries, which greatly increased the cash position of IHES. The Class A stockholders of IHES and its preferred stockholders were persuaded to harmonize their previous differences and to execute the compromise agreement of March 26, 1953, above alluded to, upon assurances by the Commission's staff that the staff would support the proposal for continuance of IHES as an investment company, provided the bank debt and the IHES preferred stock were retired, leaving IHES with only one class of outstanding stock, the Class A stock, and with no domestic utility subsidiaries, IHES retaining only the stock of one foreign public utility, Gatineau Power Company of Canada.

A special election was held for the choice of the interim board of directors on April 27-28, 1954. There had been a proxy contest between two rival factions, the so-called

Todd-Jacobs group and the Johnson-Romney group. Ninety-five per cent of the outstanding Class A shares voted at the election, and on the face of the returns the Todd-Jacobs group elected five men and the Johnson-Romney group elected four. On December 8, 1954, the district court entered an order provisionally seating as the interim board of directors of IHES the nine persons so chosen, "with only the authority and for the sole purpose of representing the Class A stockholders in all proceedings before the Securities and Exchange Commission and this Court and in particular with reference to the formulation of proposals for the consummation of Part IV (First Amendment) of the Trustee's Second Plan."

The interim board in January, 1955, filed its plan, under which IHES (renamed Abacus Fund) would continue as a closed-end investment company, with minor and non-controversial amendments to the old declaration of trust in the direction of increasing the protection of the stockholders. Upon registration as an investment company, it was proposed that the Commission would issue an order exempting the company as a holding company under §3(a)(5) of the Act.

A different plan was filed by appellants Johnson and Central-Illinois Securities Corporation, supported in the main also by appellant The Equity Corporation. Under this rival plan, IHES would be split into two registered investment companies, each to hold an aliquot portion of the present IHES assets. It was assumed that the stockholders in the Todd-Jacobs group would generally stay with IHES, while stockholders in the Johnson-Romney group would affiliate with the new company. No such split-off was suggested at the time of the proxy fight for election of the interim board, at which time the Johnson-Romney group was contending for mastery of the whole

investment potential of IHES as a unified fund. The Johnson plan also provided that dissenting shareholders, who did not wish to affiliate with either investment company, would be entitled to withdraw upon receiving their pro rata share of the net assets of the estate. It was also provided that unless at least two thirds of the Class A stock accepted the Johnson plan, IHES would forthwith be liquidated, though under the IHES declaration of trust it required a vote of two thirds of the shares to compel a liquidation.

After lengthy hearings on the plans, the Commission on November 23, 1955, filed its Findings and Opinion in which, after pointing out certain favorable tax consequences which would inhere in the interim board plan and be jeopardized or frustrated in the Johnson plan, it concluded that the interim board plan, with minor amendments, was the only plan submitted which could receive its approval. The Commission also stated that if its suggested changes in the interim board plan were made by the board, "the 1942 order directing the liquidation and dissolution of IHES may be modified so as to permit its transformation into an investment company, that IHES will qualify for an exemption under Section 3(a)(5) of the Act following such transformation". The interim board having promptly amended its plan to conform with the Commission's suggestions, the Commission on January 13, 1956, entered its order finding that the interim board plan, as amended, was an appropriate means for effecting compliance with §11(b)(2), was fair and equitable and satisfied the other applicable provisions of the Act, and it was further ordered that the Commission's dissolution order of July 21, 1942, "be and it hereby is modified to the extent necessary to permit IHES to consummate the aforesaid Interim Board plan; provided

however, that if said Interim Board plan be not approved and enforced by the Court or if said plan be not consummated the said order of July 21, 1942 shall be deemed to be in full force and effect as if not modified herein."

By supplemental application in the long-drawn-out proceeding before the district court, the Commission requested the court to approve and enforce the plan of the interim board. After notice and hearing, the court on April 23, 1956, adopted as its own the findings of fact and conclusions of law of the Commission dated November 23, 1955; approved the interim board plan "as fair and equitable, as appropriate to effectuate the provisions of Section 11 of the Act, and as satisfying the other applicable provisions of the Act." Further, the court order directed the trustee promptly to call a meeting of Class A shareholders for the purpose of electing a board of nine directors of IHES as reorganized pursuant to the plan. This order of the district court of April 23, 1956, is the one now on appeal.

We think there can be no substantial doubt of the power of the Commission to make an appropriate modification of its outright dissolution order of July 21, 1942, notwithstanding the fact that in 1943 that dissolution order was sustained on review by the Court of Appeals for the Sixth Circuit. In support of this conclusion we need look no further than to the unqualified statutory authority in the last paragraph of §11(b) of the Act: "The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24." See *American Power & Light Co.* v. *S.E.C.*, 329 U. S. 90, 121 (1946). Appellants have misconceived

our holding in *Bailey* v. *Proctor*, 166 F. 2d 392 (1948), in relying upon that case as authority for the proposition that the Commission needed to obtain prior leave from the Court of Appeals for the Sixth Circuit before proceeding to modify its dissolution order of July 21, 1942. See *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 140-44 (1940). And the judgment of the Court of Appeals for the Second Circuit (184 F. 2d 646) sustaining an order of the Commission in 1949 disapproving the Todd plan for modification of the dissolution order so as to permit the continuance of IHES as an exempted holding company, was no barrier to the subsequent determination of the Commission, having in view the drastically altered condition of IHES as it existed on January 13, 1956, to modify its earlier order of dissolution so as to permit the consummation of the interim board's plan contemplating the continued existence of IHES as an investment company. Nor does the fact that the jurisdiction of the court below was first invoked under §11(d) of the Act for the purpose of having that court enforce compliance with the Commission's earlier dissolution order prevent the Commission from subsequently modifying such order as above stated. By force of the authority of §11(b) of the Act, as above recited, when the Commission modified its 1942 order to permit compliance by an alternative method, the district court's jurisdiction was not ousted but was continued to enforce the Commission's order as modified. And, of course, the district court's order now under review, approving and enforcing the interim board's plan for converting IHES into an investment company, by necessary implication constituted an approval by the court of the Commission's aforesaid modification of its earlier dissolution order.

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Also, we think it clearly appears from the Commission's elaborate findings and opinion, if not from the abbreviated statement of the case which we have made above, that there was ample evidence to sustain the Commission's conclusion that the interim board's plan should be approved as fair and equitable and in compliance with all the provisions of the Act. Nor can we say that the district court erred in adopting as its own the findings and conclusions of law of the Commission.

There is no doubt that the remedy of dissolution is not the only means for achieving the statutory objective of eliminating useless holding companies; transformation into an investment company may also be a permissible method of ceasing to be a holding company. *Downing* v. *S. E. C.*, 203 F. 2d 611, 622 (C.A.D.C. 1953), cert. denied 346 U. S. 930 (1954).

We cannot accept appellants' arguments that the approved plan is necessarily unfair and inequitable (1) because the proposed transformation of IHES into an investment company was not made subject to an approving vote of at least two thirds of the Class A stockholders, as provided in the Johnson plan, or (2) because the approved plan contained no provision permitting dissenting shareholders to withdraw from the trust upon payment for their shares (of course, they are free to sell to outsiders if they want to get out). Approval by vote of the shareholders of a plan otherwise in compliance with the standards of §11(b) is not made mandatory by any statutory requirement. See *Phillips* v. *S. E. C.*, 153 F. 2d 27 (C.A. 2d, 1946), cert. denied 328 U. S. 860 (1946). Though the Commission at an earlier stage approved plans having this feature, after further experience with the undesirable delays and controversies which often accompanied such a requirement of a stockholders' vote,

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the Commission adopted the policy of refusing to impose a voting requirement. See the extensive discussion by the Commission in *Electric Bond and Share Company*, Holding Company Act Release No. 11675 (1953). Furthermore, as pointed out by the Commission, a new vote on this issue by the Class A stockholders would serve no useful purpose. As stated in the Commission's opinion, the 1954 proxy contest incident to the selection of the interim board of directors pursuant to the compromise agreement of March 26, 1953, at which 95 per cent of the outstanding Class A stock voted, "was carried out in an atmosphere of continuation of IHES as an investment company. Each of the contesting groups represented from the beginning and throughout the contest that its objective was to convert IHES into an investment company with full preservation and realization upon its tax situation". In addition to that, under the approved plan there will, upon registration of the reorganized IHES as an investment company, be an election by the Class A stockholders of a new board of directors; and, of course, if the Johnson-Romney faction obtains a majority of the board at such election, it will come into control of the investment policies of the continued company. It is also to be pointed out that, after the approved reorganization is completed, the stockholders, if they wish, may exercise their franchise and cause liquidation of IHES, provided they obtain a two-thirds vote for that purpose in accordance with the terms of the declaration of trust; whereas, under the disapproved Johnson plan, it was in effect sought to enforce a dissolution of IHES by vote of less than a majority of the stock.

Likewise, there is no specific statutory requirement that a plan under §11(b), to be approved as fair and equitable, must contain a provision permitting withdrawal by dis-

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senting stockholders. In this connection it is to be noted that, under the disapproved Johnson plan, dissenting stockholders were not to be paid off in cash, as is provided under some state corporation laws, but were to be given a right of withdrawal from the enterprise upon payment to them of an aliquot share of the portfolio assets. Furthermore, appraisal rights of dissenting stockholders, as provided in Massachusetts law applicable to corporations, do not extend to IHES, organized as a Massachusetts trust; and as we have already observed, apart from the provisions of the Holding Company Act, the directors of IHES, under the powers vested in them by the declaration of trust, could have disposed of the portfolio of domestic utility companies and reinvested the proceeds in any other type of business or securities—this without any right of withdrawal by a dissenting stockholder. As the Commission stated, many plans under §11(b) which have been approved both by the Commission and by the courts did not afford a right of withdrawal to dissenting stockholders, even where (as is not the case here) approval of such plans involved disregarding withdrawal rights existing under corporate charters. For these, and other reasons fully spelled out in the Commission's opinion, it was obviously within the Commission's broad discretionary power to approve the interim board plan though the plan did not contain any withdrawal provision.

Other contentions by appellants have been considered, but we think they do not have sufficient merit to call for special discussion.

The order of the District Court is affirmed.

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APPENDIX B

The provisions of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U.S.C. 79 *et seq.* are in pertinent part as follows:

* * * * *

SEC. 11. * * *

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938: * * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company. The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order

was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SEC. 24. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by

filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission for that purpose, and thereupon the Commission shall certify and file in the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

FILED
JAN 7 1957
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 626

CENTRAL-ILLINOIS SECURITIES CORPORATION AND C. A. JOHNSON,
Petitioners,

v.

BARTHOLOMEW A. BRICKLEY, Trustee, SECURITIES AND EXCHANGE COMMISSION, ET AL.,
Respondents.

No. 630

THE EQUITY CORPORATION,
Petitioner,

v.

BARTHOLOMEW A. BRICKLEY, Trustee, and the SECURITIES AND EXCHANGE COMMISSION, ET AL.,
Respondents.

BRIEF ON BEHALF OF RESPONDENTS LUCINDA BUNNEN, *ET AL.*, IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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Introductory Statement

This brief is submitted on behalf of respondents Lucinda Bunnen, six other individuals and one estate, who at the time of the hearing before the Securities and Exchange

Commission, were direct and beneficial owners of 170,800 shares of Class A stock of International Hydro-Electric System (IHES), a Massachusetts trust.

Respondents oppose the issuance of writs of certiorari to review the decision of the Court of Appeals for the First Circuit, dated October 26, 1956. This decision unanimously affirmed an order of the United States District Court for the District of Massachusetts entered April 23, 1956, under Section 11(d) of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U.S.C. §79k(d), approving and enforcing a plan of reorganization of IHES, which had been unanimously approved by the Securities and Exchange Commission as a fair and equitable means of compliance with Section 11(b) of the Act. Respondents submit that petitioners have made no showing that should lead this Court to exercise its discretionary power to review a unanimous order of a Federal administrative commission which has been affirmed by two courts without a dissenting voice.

Statement of the Case

It is not necessary to review in detail petitioners' statements of the case, since most of the facts stated are not material to the legal issues presented. However, the very length of petitioners' statements obscures the essentials. Petitioners seek to present a picture of IHES being "transformed" and "transmuted"*. In fact, all that is involved is the continuation of IHES in one of the very activities that it was formed to conduct, after all conflict with applicable laws has been eliminated.

The essentials with respect to the organization of IHES are stated in the opinion of Chief Judge Magruder as follows (Petition in No. 630, p. 41):

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* Petition in No. 626, pp. 2, 13, 14, 15, 16; Petition in No. 630, pp. 6, 37.

> "IHES was organized as a Massachusetts business trust, under an original declaration of trust dated March 25, 1929, and since amended from time to time. The trustees, and by delegation the board of directors, were given the broadest discretionary powers to engage in almost any sort of business activity—this without the requirement of a favoring vote by the shareholders, and without any obligation on the part of the trust to buy out a dissenting shareholder. Thus, though IHES started out as a holding company in the public utility field, the trustees and/or the board of directors, if they deemed it advisable, were fully empowered to dispose of the utility subsidiaries of the trust and to transmute IHES into an investment company."

In 1940, the Securities and Exchange Commission (SEC) instituted a proceeding under Section 11 of the Public Utility Holding Company Act, 15 U.S.C. §79k, to determine what action IHES must take to comply with the simplification standards of Section 11(b)(2), 15 U.S.C. §79k(b)(2). On July 21, 1942, the Commission issued an order requiring that IHES be liquidated and dissolved, such liquidation and dissolution to be "carried out with care and in a manner which subserves the public interest in every particular." *International Hydro-Electric System*, 11 S.E.C. 888, 908 (1942).

At the time of the SEC's dissolution order, IHES had an exceedingly complicated capital structure. This consisted of debentures which were to mature on April 1, 1944, of cumulative preferred stock on which no dividends had been paid since 1934, and of Class A stock. Although IHES' assets were then worth little more than the amount due on the debentures, it was, as described in *Todd* v. *Securities and Exchange Commission*, 137 F. 2d 475, 477, (6th Cir. 1943), "the top holding company in a four-tier group of utility companies consisting of 74 active corporations, of which seven are holding companies only,

fifty are electric and gas utility companies, and seventeen are companies engaged in the business of water storage, transportation, real estate, and other activities."

In view of the inability of the IHES management to come forward with a satisfactory plan for orderly liquidation and the approaching maturity of the debentures, the Commission, in 1943, filed in the United States District Court for the District of Massachusetts an application under Section 11(d) for a decree enforcing compliance with its 1942 dissolution order. The District Court took jurisdiction of IHES and appointed Bartholomew A. Brickley as Trustee, in 1944.

As a result of the administration of IHES by the District Court and its Trustee, between 1949 and 1953 the capital structure of IHES was simplified and its holdings were disposed of to the point where conflict with the Public Utility Holding Company Act no longer existed. The capital structure of IHES now consists only of 856,718 shares of Class A stock. Its assets consist of cash; of all of the common stock of Eastern New York Power Corporation, a non-operating company whose assets likewise consist almost entirely of cash; of 18.8% of the common stock of Gatineau Power Company, a Canadian public utility; and of 4.6% of the common stock of New England Electric System, a registered holding company (R. 850-851).

The only basis on which IHES has remained a "holding company" under Section 2(a)(7) of the Public Utility Holding Company Act, 15 U.S.C. §79b(a)(7), even technically, was its 18.8% ownership in Gatineau (R. 850). However, since Gatineau's business is wholly without the United States, IHES is entitled, under Section 3(a)(5), 15 U.S.C. §79c(a)(5)*, to an exemption from the Act.

If in 1940 IHES had the capital structure and the holdings which it has today, the Commission would have never

* This section is quoted in Appendix A.

taken any proceedings under Section 11(b) and IHES could have engaged in any activity within the purview of its broad declaration of trust that recommended itself to the business judgment of a majority of its board of directors. A change in policy so as to invest outside the utility field would not have required any vote of stockholders, except, of course, the annual vote for the election of directors, and would not have given any stockholder the privilege of withdrawing his investment. IHES would simply have conformed to any applicable provisions of law, including, if IHES were to engage in activities within the ambit of the Investment Company Act of 1940, 54 Stat. 789, 15 U.S.C. §80a, registration under that Act.

The effect of the action of the SEC, which the District Court "enforced" by the order that the Court of Appeals affirmed, is simply to permit this, despite IHES' previous involvement with Section 11(b) of the Public Utility Holding Company Act, which has now been cured. By its order of January 13, 1956 (R. 876-79), the SEC modified its dissolution order of July 21, 1942, to the extent necessary to permit IHES to carry on as a registered investment company under a plan proposed by the Interim Board of Directors installed by the District Court for that purpose (R. 559). By its order of April 23, 1956, the District Court directed the Trustee to conduct an election of new directors, to turn over the assets of IHES to them, and, as soon as the Commission shall have issued an order exempting IHES pursuant to Section 3(a)(5) of the Public Utility Holding Company Act, to register IHES under the Investment Company Act of 1940 (R. 891-99).

Questions Presented

Despite the lengthy statement of questions in the petitions, petitioners' primary grounds of attack upon the order of the Commission and that of the District Court were two.

The first was a claim that, under the circumstances here presented, the SEC was without power to modify its 1942 order dissolving IHES under Section 11(b)(2)—even though any basis for dissolution from the standpoint of the public objectives of the Holding Company Act had disappeared.

The second was a claim that it was an error of law or, at least, an abuse of discretion for the SEC not to impose as conditions to its modification of the dissolution order (1) that one-third of the stockholders of IHES should have a veto over its continued existence, and (2) that any stockholder of IHES should be permitted to withdraw in kind, a *pro rata* part of IHES' assets.

The District Court and the Court of Appeals properly held that these contentions were unfounded. Neither these primary contentions of petitioners nor certain collateral matters now stressed afford the slightest ground for this Court's exercising its discretionary power of review.

ARGUMENT

1. *The claim that the SEC lacked power to revoke or modify its order dissolving IHES.* The power of the SEC to revoke or modify its 1942 order of dissolution follows from the plain language of the statute. Section 11(b)(2) provides, immediately after the grant to the SEC of the power to order dissolution:

> "The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist." 15 U.S.C. 79k(b)(2)

It is difficult to see how Congress could have empowered the Commission more clearly or broadly to revoke or modify a dissolution order. The only limitation is that the Commission must find "that the conditions upon which

the order was predicated do not exist." Petitioners do not even claim that the Commission lacked evidentiary basis for making this finding in the case of IHES. There could be no such claim in view of the fact that compliance with the Holding Company Act had been completely effected, to the point where IHES is entitled to an exemption. See *General Protective Committee* v. *Securities and Exchange Commission*, 346 U. S. 521, 530 (1954).

The clear-cut power of the SEC to revoke its orders of dissolution has already been recognized by this Court in *American Power & Light Co.* v. *SEC*, 329 U. S. 90, 121 (1946) where, in upholding an order of the Court of Appeals for the First Circuit which sustained a dissolution order of the SEC, this Court stated:

> "Moreover, a §11(b)(2) proceeding leads only to the expression of the Commission's view of what must be done to ensure compliance with the statutory standards. Actual compliance comes later. In the meantime, nothing precludes American or Electric from seeking revocation of the dissolution orders on a showing that the conditions upon which the orders were predicated do not exist, thereby making some other type of order more appropriate * * *"

This same statement negates petitioners' claim that the power thus confided by Congress to the SEC was affected by the dismissal by the Court of Appeals for the Sixth Circuit of a petition to review the 1942 dissolution order, *Todd* v. *Securities and Exchange Commission*, 137 F. 2d 475 (6th Cir. 1943), or by the Second Circuit's affirmance of an order of the SEC refusing to modify it seven years later, *Protective Committee* v. *Securities and Exchange Commission*, 184 F. 2d 646 (2d Cir. 1950). These courts merely found there was no error in the SEC's 1942 order or in its refusal to modify the order in 1949 when the SEC could not find "that the conditions upon which the

order was predicated do not exist." They were not decisions that the SEC could not exercise the express power to revoke the dissolution order given by Congress, when it *was* able to make the statutory finding. The Court of Appeals held (Petition in No. 630, at pp. 47-8) that petitioners' argument to the contrary, based on that Court's own decision in *Bailey* v. *Proctor*, 166 F. 2d 392 (1st Cir. 1948), dealing with the relations between higher and lower courts, "misconceived" that decision; and that, in revoking the dissolution order the Commission had acted within its statutory powers, as recognized by this Court in *American Power & Light*, and consistently with the views expressed in *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U. S. 134, 140-4 (1940).

Petitioners' contention, that once a court has upheld an order of a Federal administrative agency, the situation is frozen and the agency is rendered powerless to exercise a statutory power to modify or revoke its order except with prior permission of the court, carries its own refutation. As recognized by this Court in *American Power & Light*, the question whether conditions have so changed as to require modification or revocation of the order of an administrative commission is by its very nature a question for primary determination by the commission, not by a court. The Court of Appeals correctly distinguished *Bailey* v. *Proctor* on this ground. In any event, the interpretation of its own decision in *Bailey* v. *Proctor* was peculiarly a matter for the Court of Appeals and raises no question of general importance warranting the grant of certiorari.

2. *The claim that the SEC was required to give petitioners a veto or a withdrawal privilege.* Petitioners' second contention was equally without merit. Petitioners could not point to any provision, either of Massachusetts

law or of any other applicable law, permitting one-third of the stockholders to veto a Massachusetts trust's right to continue in any business within its declaration of trust, or entitling a dissatisfied stockholder to withdraw a *pro rata* share of the assets. Their contention thus necessarily became that the Commission abused its discretion in not so conditioning, for petitioners' private benefit, the modification of the order dissolving IHES which it had entered in 1942 to enforce the public objectives of the Act.

Petitioners here were asking the Commission to make a special exception, in their favor, from general policy determinations which it had previously reached in its administration of the Holding Company Act. In *Electric Bond and Share Company*, Holding Company Act Release No. 11,675 (1953), the Commission had decided, as a matter of general policy, that when a holding company had met the simplification requirements of the Act, the "fair and equitable" clause of Section 11(e), 15 U.S.C. §79k(e), did not require that the company should subject the question of its continued existence to a vote by stockholders* or give dissatisfied stockholders the privilege of withdrawal. The Commission reached this decision by just such a review of its experience as this Court approved in *Securities and Exchange Commission* v. *Chenery Corporation*, 332 U. S. 194 (1947). The question whether the Commission should have excepted petitioners from this general policy because of alleged unique and distinguishing facts existing in the instant case was peculiarly a matter for the Commission to determine in the light of the record and its long experience. As said by this Court

* Actually the petitioners will still have their vote under the plan. As pointed out by Chief Judge Magruder, if a majority of the stockholders of IHES are not satisfied with the plan approved by the Commission, they will elect a majority of the board of directors at the election which the District Court has ordered the Trustee to conduct, and will control the future plans of the Company. (Petition in No. 630, at p. 50.)

in *American Power & Light Co.* v. *Securities and Exchange Commission*, 329 U. S. 90, 112-13 (1946):

> "* * * the Commission here has accumulated experience and knowledge which no court can hope to attain. Its judgment is entitled to the greatest weight. While recognizing that the Commission's discretion must square with its responsibility, only if the remedy chosen is unwarranted in law or is without justification in fact should a court attempt to intervene in the matter."

The Court of Appeals was manifestly correct in holding that the Commission had not abused its discretion in finding that the petitioners had shown no basis for exception to the Commission's general rule. In any event petitioners' appeal, based, as it is, on the alleged uniqueness of the facts in this case, clearly presents no question of general importance.

3. *The claim in regard to Section 36 of the Investment Company Act.* A considerable part of the petition of The Equity Corporation (No. 630) is devoted to an attack upon the Commission's order upon another ground. This is that the Commission should have declined to modify its order of dissolution of IHES because these respondents and others had "acquired secretly in a single transaction a controlling block of 250,000 shares shortly before the election of the Interim Board without any similar offer to purchase from other stockholders" (Petition in No. 630, pp. 26-27). The claim is that "had IHES been a registered investment company these acts would have constituted a gross abuse of trust under Section 36 of the Investment Company Act" (Petition in No. 630, p. 31).

A sufficient answer, of course, is that when the purchase was made, IHES was not a registered investment company and, indeed, still is not. Moreover, there is not the slightest support for the contention that this purchase was in any way an abuse of trust. The 250,000 shares were

purchased from some six different interests (R. 337). These interests had no association with each other, except a common desire not to remain stockholders of IHES. They had nothing to do with the management of IHES, which was in the hands of the Trustee appointed by the District Court, and, accordingly, had no fiduciary relation to other stockholders. The sale of their shares gave the purchasers, some 41 accounts in number, only what the sellers had had—a chance to win a majority of IHES' directors if enough other stockholders were of like mind, as they proved to be. The stock was purchased at approximately the then market price (R. 829), which was somewhat less than the book value (R. 598), and has never sold lower (R. 598).

The Commission found that:

> "Although it would appear that this entire matter is irrelevant in the context of the problem before us, in any event, we find no evidence of illegality in the acquisitions and it does not appear in the circumstances that it was incumbent upon the purchasers to announce their intention to buy the shares" (R. 867-68).

Not only, therefore, was Section 36 of the Investment Company Act, 15 U.S.C. §80a(35), relating to gross abuse of trust not applicable to the transaction here in question, but there was no "trust" and no "abuse", let alone a "gross abuse." The entire argument is simply an effort, manifestly unsuccessful, to attract the interest of the Court in a question as to the interpretation of Section 36 of the Investment Company Act, which may be presented some time but is not here.

4. *The claim that the District Court should have considered the matter de novo.* Equally unpersuasive is the claim, made by the Central Illinois-Johnson petition (No. 626, pp. 16-17), that since here the Commission was apply-

ing for the enforcement of a plan under Section 11(d), the District Court should not have given the Commission's determination here the effect normally given to an administrative determination, which this Court has held must be done when a District Court is asked to enforce a plan approved under Section 11(e). *Securities and Exchange Commission* v. *Central-Illinois Securities Corporation*, 338 U. S. 96 (1949). The statute affords no basis for the distinction which petitioner would draw. Petitioner argues that under Section 11(d) the Commission may itself formulate a plan, whereas Section 11(e) deals with company formulated proposals. Section 11(d) also permits the plan to be formulated by private interests, as was done here, and Section 11(e) authorizes the Commission to modify a company formulated plan, as it regularly does. Under either subsection, therefore, the approved plan will be what the Commission finds best out of all proposals before it—some privately originated and some Commission originated. Moreover, the basis for judicial deference to administrative action relates to the knowledge and judgment that went into the action—not to who initiated it. Finally, since this case is the only case which has arisen or is likely to arise under §11(d), petitioner's argument is peculiarly unpersuasive.

CONCLUSION

The petitions for certiorari should be denied.

Respectfully submitted,

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APPENDIX A

Section 3(a)(5) of the Public Utility Holding Company Act, 15 U.S.C. §79(c)(a)(5):

> (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this chapter, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—
>
> • • •
>
> (5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company.